Issues and Alternatives·1976

Ontario Economic Council

National Independence

HC
117
.06
.I8262

REFERENCE COPY

REFERENCE COPY

NATIONAL INDEPENDENCE

ISSUES AND ALTERNATIVES

1976

ONTARIO ECONOMIC COUNCIL

Ontario Ministry of Treasury,
Economics and Intergovernmental
Affairs Library

APR 14 1976
76/58445
LIBRARY

HC
117
0618262

TABLE OF CONTENTS

		PAGE
	PREFACE	V
	MEMBERS OF THE ONTARIO ECONOMIC COUNCIL	VII
I.	INTRODUCTION	1
II.	ECONOMICS AND POLICY FORMATION	3
	What is National Independence?	3
	Policy Trade Offs	4
	Techniques	6
	Income Distribution	8
	Regional, Constitutional and Spillover Aspects	8
III.	FOREIGN OWNERSHIP POLICY	11
	Surveillance, Screening and Guidelines	12
	Tariff Policy	15
	Competition Policy	17
	Financial Markets	18
	Tax Policy	20
	Research and Development	23
	Other Industrial Policies and Issues	24
	Land Ownership	25
IV.	CULTURAL NATIONALISM	27
	Publishing	27
	Broadcasting	30
	Education	31
	Other Areas of Concern	32
V.	SUMMARY AND MAIN POLICY ISSUES	33
	DISSENTING COMMENT	35
	FOOTNOTES	37

Digitized by the Internet Archive
in 2018 with funding from
Ontario MInistry of Finance

https://archive.org/details/nationalindepend00onta

PREFACE

The most striking feature of public affairs during the past two decades has been the rapid growth in the size and complexity of government. Reflecting this development, the Ontario Economic Council two years ago decided to focus much of its attention on government expenditure programs, particularly in the four fields of health, education, urbanization, and social security. In considering each of these fields, special emphasis has been given to two basic themes: the size, growth and effectiveness of public expenditure programs; and the impact of these programs upon the personal distribution of income and wealth.

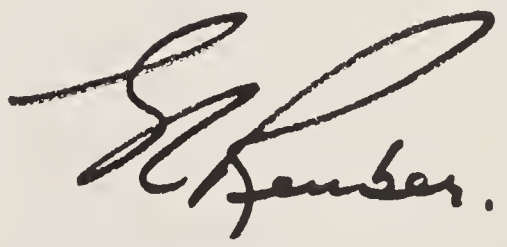
In addition to its work on public expenditure programs, the Council has also given priority to two related topics: national independence and the development of Northern Ontario, both of which pose long-standing concerns.

This is one of a series of papers that the Council is issuing on each of the six areas where we are concentrating our attention at present. The purpose of these papers is to highlight the principal issues, as we see them, and to provide a framework for discussion about improvements in government policies in these areas.

In this paper we raise what we regard as the most pressing issues of the day concerning national independence. We also offer suggestions which we believe warrant further examination for alternative policy approaches to these issues. The Council itself is undertaking research to explore some of the questions that arise, which will be made public as it is completed.

It is the Council's hope that this report will make a useful contribution to the evolution of public policy as it affects questions of national independence.

While each member of the Ontario Economic Council does not necessarily subscribe completely to everything said in this report, the report does reflect a strong consensus of Council Members' views.



G.L. Reuber
Chairman
Ontario Economic Council

MEMBERS OF THE ONTARIO ECONOMIC COUNCIL*

G.L. Reuber, Chairman

Mr. David B. Archer
President
Ontario Federation of Labour

Mr. Reuben C. Baetz
Executive Director
Canadian Council on Social Development

Mr. Charles J. Carter
President
The Great Lakes Paper Company Limited

Mr. J. Douglas Gibson
Financial and Economic Consultant

Dr. Elizabeth A. Gullett
Associate Professor
Department of Consumer Studies
University of Guelph

Mr. H. Clifford Hatch
President
Hiram Walker-Gooderham & Worts Ltd.

Mr. Rowland G. Hill
Vice-President and Canadian Regional Director
International Union of Operating Engineers

Mr. E. Lynn Hollingsworth
Vice-President
Soo Mill and Lumber Company Limited

Mrs. Pauline Joyal
Social Worker
Ottawa

†Mr. Lorne K. Lodge
President and Chief Executive Officer
IBM Canada Ltd.

Mr. William F. McCormick
President
Glen Highland Holdings Limited

Miss J.C. McKibbon
Administrative Officer
London Life Insurance Company

Mr. John T. Pennachetti
Chairman
General Concrete of Canada Ltd.

††Dr. A. Edward Safarian
Dean
School of Graduate Studies
University of Toronto

Dr. David C. Smith
Head
Department of Economics
Queen's University

Mr. Andrew Stewart
Chairman of the Board
Fanshawe College
London

Mr. Robert B. Taylor
Chairman
Hydro Electric Power Commission of Ontario

Mr. William P. Wilder
Chairman
Canadian Arctic Gas Study Ltd.

† Mr. Lynn R. Williams
Director, District 6
United Steelworkers of America

Dr. David M. Winch
Chairman
Department of Economics
McMaster University.

* Members prior to December 1975 and participants in the preparation of this report.
†† Chairman of the Ad Hoc Committee on National Independence.
† Members of the Ad Hoc Committee on National Independence.

I. INTRODUCTION

A nation with a small population relative to its external environment must necessarily import a wide range of goods and services. The alternative is to forego the substantial economic benefits inherent in specialization. The importation of foreign capital over some period of its history enables a nation to grow more rapidly. Often ignored, but equally valid, a nation like Canada is likely to import people who enter the work force and contribute to entertainment and culture for its leisure.

It is probably inevitable that concern about national independence has grown and that self doubts have developed about our national identity. But changes, responsive to these concerns and doubts, cannot be easily accomplished. National tastes and attitudes have been conditioned by foreign influences. Vested interests are well entrenched.

Canada has drawn upon foreign capital sources over most of its history. In the past twenty years questions have been raised about the composition of the capital inflow - why is it mainly *direct* rather than *debt* or *portfolio* investment? Direct investment carries with it control over management, finance, technology, production and exports. Debt and portfolio investment do not. Debt investment has a definite maturity and fixed service costs. Direct investment is open ended.

Canadians are also concerned that the benefits of direct investments may not be favourable, relative to the costs involved. They are concerned that decisions affecting their welfare are made beyond their jurisdiction — beyond their national control.

Many other difficulties are cited. These include the exploitation of natural resources by foreign firms, the pricing policies of foreign firms, the allocation of tax revenues and the ownership of real estate by non-residents.

Questions in the cultural and educational fields are, at least, equally difficult, and have been subjected to far less study than the foreign investment question. The common thread of concern relates to Canadian content in advertising, book and magazine publishing, higher education, and radio and television coverage.

This paper seeks to do three things.

1. It outlines, in general terms, the economic and social aspects of policy formation in the area of "independence".
2. It surveys existing policies and legislation and discusses their implications.
3. In conjunction with the analysis of existing policies, it outlines some of the major issues to be faced in the future.

The Council is currently undertaking research that it expects will make more substantial observations and result in more specific recommendations on a number of topics in this area.

Before proceeding, one should perhaps ask the obvious question: Has enough not already been said about foreign ownership, and economic and cultural nationalism in this country?

Canadians have been bombarded by reports dealing with foreign direct investment, the Watkins, Wahn, Gray, and Select Committee documents, not to mention numerous academic publications.[1] The general consensus of these reports is that, in the past, foreign firms have contributed to our growth and development but that the time has come to

develop our indigenous talents and resources to a greater degree and to control our own economic future to a greater extent. The reports typically have emphasized the possibilities for conflict between multinational corporations and the Canadian interest. They have suggested policy responses.

The Council holds the view that the actual evolution of policy has been haphazard. It probably pleases no one. The policies adopted have been piecemeal. They have applied to some sectors and not to others. They have applied for some forms of ownership and not to others. They have introduced biases, either across sectors or between projects. In addition, the periodic subjugation of foreign ownership policies to other economic goals means that advantageous foreign investment may be downgraded in "good" years while in "bad" years less adequate investment (in a benefit-cost sense) may be accepted for reasons related to employment, balance of payments, regional development and so forth.

What are the implications to the residents of Ontario of the answers to these questions? Have the policies, particularly the policies of the Government of Ontario, been well conceived? In the industrial area, as distinct from culture and land ownership, federal policy has been dominant, expressed in such initiatives as the Canada Development Corporation and the *Foreign Investment Review Act*. However, the Select Committee on Economic and Cultural Nationalism of the Ontario legislature has produced a number of reports focussing on the industrial area.[2] The implications of these reports for Ontario, however, are not obvious. There was relatively little research support available to the Select Committee which assessed the possible impact of policy changes. It should also be noted that, although there is evidence of many potential conflicts between foreign firms and Canadian interests (which the Select Committee documented), interpreting the causes of conflict is difficult and so is making credible estimates of the possible consequences of corrective policies.

Two general points should be mentioned about nationalism before proceeding further.

1. Nationalism can be purchased in many ways — by discriminating against foreign capital, labour, imports, entertainers, educators or, more generally, foreign cultural activities. Each initiative will result in some Canadians profiting and having a positive interest in the restrictions, while, in varying degree, other Canadians will bear the costs and be adversely affected by the restrictions.

This leads to the second point

2. Nationalism is a public good — once it is provided it is difficult, if not impossible, to exclude it from individual Canadians who may not want it or may not wish to absorb the costs it imposes.

II. ECONOMICS AND POLICY FORMATION

Ideally, policy formation should be geared to well defined goals. Substantial information on the problem, and its interdependence with the social, economic and political sectors, should be available; equally there is need for a conceptual framework that illustrates the predictable effects on these goals resulting from the use of certain policy instruments. Unfortunately, reality is rarely so simple. In terms of national independence, however, goals are poorly defined and spillovers are difficult to estimate. Concern centres on the vague issues of foreign control and influence rather than on the more concrete variables with which economists usually deal and, as a consequence, economic examination is incapable of producing conclusive answers.

What is National Independence?

The term "national independence" is difficult to define. To some it implies self sufficiency in terms of the goods we produce and consume. To others it implies Canadian sovereignty — the ability to make Canadian policies within the country without international constraints. To still other groups it implies removing or reducing foreign ownership, foreign teachers or some other type of foreign presence or influence.

The difficulty is not exclusively semantic. The illusive character of "national independence" also flows from one of the implications of generally accepted economic theory: viz, trade in goods and services and movements of capital and movements of labour (immigration) are substitutes for one another.[3]

Restricting trade has the effect of providing an incentive for the movement of labour and capital. Restricting the movement of people or capital encourages trade. In other words, the interdependence of economic life is pervasive and many of the difficulties in formulating "independence" policies flow from this harsh reality.

The interdependence of tariffs and trade with incoming foreign capital illustrates one aspect of these difficulties. Canada, as a new nation, historically has been dependent on imports to meet many of her needs. In 1879 the National Policy was adopted and its purpose was to promote Canadian industrialization. The vehicle employed was the protective tariff. Tariff protection was increased further during the depression of the 1930s. One consequence was the establishment of branch plants of foreign firms in Canada. Some national independence was gained in domestic production but it was achieved at the price of a loss of independence in terms of the ownership of real assets. In addition, higher costs were imposed on the Canadian consumer because, in the small Canadian market, plants were of a smaller scale, production runs were shorter and, as a consequence, economies of specialization were foregone.

When considering foreign ownership in the context of the present we must be assured that we are not naively trading one type of dependence for another, or paying a cost that, at the outset, is not clearly defined or understood.

Canada moved to its present position essentially as a result of political decisions. This is unchanged — any reduction of economic and cultural dependence is equally a political matter. But the political process often fails to define or to state the ultimate costs. The political advocate often touts the benefits while hiding costs and their incidence.

Policies designed to increase national independence, because they are structural, have long term effects. The total costs and benefits can be expected to be far from obvious, even after the policy is operative. Quite possibly the political costs, which may be expressed as a loss of electoral support, will not be paid by the government that institutes them.

The question of being independent of foreign capital, although usually discussed at the level of direct investment, also relates to other capital inflows. Indeed, there is a large literature that addresses the effect of capital flows on the ability of a country to operate "independent" monetary and fiscal policies. The answer depends, at least in part, upon whether fixed or floating exchange rates are adopted. Canada's decision to have a floating rate in the 1950's and, again, since 1970, reflects a preference for a monetary policy (and a rate of inflation) different from that of its neighbours and, in particular, the United States.

There is another aspect of national independence that should not be ignored. If national independence, why not provincial independence? There are many barriers to the movement of goods, people and capital between provinces of Canada.[4] Provincial governments have played an instrumental role in the creation of these barriers. One of the major strengths of a federal system is that provincial governments are more likely to be aware of different regional needs, attitudes and aspirations. The Council believes that this diversity should be recognized and encouraged. But to attempt to serve narrow provincial economic interests through placing barriers on the internal movement of goods, services, capital and people would clearly be in conflict with the national interest and almost inevitably would be in conflict with the long term provincial interest.

Canada is a small market. To balkanize it by erecting provincial economic barriers is to exacerbate an existing problem. Ontario is not a major offender in the matter of economic provincialism. It must be acknowledged, however, that Ontario likely gains relative to other provinces through the tariff, the auto agreement and other relevant federal actions. The adoption of freer trade policies at the federal level would further strengthen Ontario's case against inter-provincial economic barriers.

Policy Trade Offs

The essence of economics is the analysis of the choice among alternatives. This obviously includes the goals of policy. Traditionally the goals have been full employment, a high rate of economic growth, reasonable stability of prices, a viable balance of payments, and a satisfactory distribution of rising incomes.[5] The relationships between these various goals are not free of ambiguities and, further, different groups are not willing to trade them off at the same rate. They do, however, provide a framework that can be used as a point of departure. But individuals have non-economic objectives that have important economic implications. Economists ignored such issues for a long time, but in recent years economic analysis has been applied to an assessment of non-economic as well as economic objectives.

It must be remembered that in earlier periods economic goals were considered to be social goals. For example, in outlining the "economic" goals noted above, the Economic Council of Canada stated that, "the main purpose of this review is to examine the problem of achieving simultaneously and consistently certain basic economic and social goals. . .".[6] The Science Council of Canada has also enunciated a set of national goals.[7] The purely economic goals are subsumed under "national prosperity".

Neither of these sets of objectives grant even a mention to foreign ownership or economic independence. Not surprisingly, the two recent major studies of the foreign ownership question produced by the federal government — the Watkins Report in 1968 and the Gray Report in 1972 — included national independence and the safeguarding of sovereignty as basic objectives of Canadians.

The goals stated by the Economic Council of Canada can be readily separated into 1) the level and growth of total Canadian income and 2) an acceptable income distribution. If a third were added it would include political and economic autonomy and an identifiable lifestyle for Canadians.

If this third goal were to be realized more fully, what effect would it have on the ability of Canadians to achieve the other two stated goals?

It is generally agreed that foreign capital has contributed to our level of income in Canada. But there is considerable doubt and debate as to the magnitude of this contribution.[8] It is probable that a lesser capital inflow would have resulted in some reduction in our standard of living. A recent survey of a sample of Ontario residents revealed that 45 percent stood prepared to accept a lowered standard of living if this would reduce or abolish U.S. investment in Canada.[9] But such statements must be accepted with some reservations. Actually foregoing consumption as a consequence of a slowed rate of growth of personal income or an absolute decline might, in the event, prove to be less palatable than was anticipated.

There is another important dimension to the so-called "independence issue". Policies that reduced the inflow of U.S. capital would almost certainly have a measurable impact on the distribution of income: restrictions on foreign direct investment probably would increase the return to domestic owners of capital and result in a decline in the real wages paid to labour.

A decision to pursue a policy to force Canadians to rely more on domestic sources of capital implies a trade-off. The purchase of autonomy in the use of capital would be exchanged for a lower rate of growth in total income and some changes in its distribution.

The exact trade-off relationships are complex and would depend upon the nature of the policies undertaken. Within Canada, the trade-off relationships — the cost — would differ by region and sector. This is also true within Ontario. The regions and industries most likely to feel the greatest impact would be those with the greatest capital requirements. Manufacturing probably would fare relatively better than mineral extraction, for example. Southern Ontario would probably suffer less of a reversal than Northern Ontario. There would also be substantial differences within groups. The market value of the assets of Canadians would be altered because the future profitability of individual companies would be affected.

This description of the nature of the policy trade-offs reflects predominantly economic rather than cultural nationalism. Cultural activities are something of a luxury, as evidenced by the fact that proportionately more are demanded by wealthy societies. This reflects the freeing of leisure time and the high fixed costs and low marginal cost of producing and distributing the output of cultural industries. The consumption of a cultural activity by one individual does not reduce the amount available to others, at least over a certain range: if they are to exist at all it follows that many cultural activities must be funded by government or private donations.

This premise, which is relevant to national policy choices, is also applicable to individuals: more culture is consumed by the higher income earner. Those contributing on the supply side of cultural activities usually require expensive training and access to a certain amount of capital. There seems little doubt that the active encouragement of increased Canadian cultural activities would benefit those in the higher income classes more than those in the lower. On the other hand, it is probable that through taxes, user charges or donations, the higher income group would be an important contributor of funds.

It is important to recognize that a trade-off is inescapable. Independence from other economies and a unique Canadian culture can only be gained at a cost. Canadians cannot be more economically and culturally independent and, concurrently, be better off. We cannot "have our cake and eat it too".

Techniques

One of the concerns expressed throughout this paper is that it may be possible to accomplish a given goal through the use of either "good" policies or "bad" policies. The question of whether a policy is good or bad can be addressed independently of the desirability of the goal itself. Most economists, for example, recommend lump sum subsidies to perpetuate desirable activities that are uneconomic rather than alternative policies that will change relative prices or will involve outright restrictions. Such policy preferences recognize that changing prices distorts the allocation of resources, including those outside the immediate industry or activity affected. Restrictions act to reduce or eliminate freedom of choice as well.

Further, the provision of subsidies from public funds is subject to audit; the use of government regulations, on the other hand, implies that resources are transferred, perhaps surreptitiously, from those paying a higher price for a protected service to those who provide the service. It is remarkably difficult to predict who the net beneficiaries will be, and in practice regulation often implies a distribution to groups who were not contemplated when the regulation was imposed — a shift that is almost certain to be undesirable.

Those who supply "desirable un-economic activities" prefer to have their livelihood maintained by increasing their prices, or by market power conferred by political or administrative fiat, rather than by subsidies. This is partly because of an apparent feeling that subsidies are demeaning as compared with other forms of government intervention. Partly, too, the lack of enthusiasm for subsidies by the beneficiaries of government intervention relates to the fact that it results in their budgetary costs being more obvious and hence more likely to be subjected to scrutiny and criticism.

The appeal of the use of the regulatory instrument arises from the fact it is the cheapest financial policy for a government. However, it may be the most expensive for a province or nation.

The imposition of a regulation typically costs the government little, and can affect the objectives of government through creating rewards for doing things that would not otherwise be done. However, this procedure has the obvious potential of perpetuating inefficiencies and encouraging the misapplication of resources. Further, once a group achieves monopoly power, or acquires a vested interest in a regulation, change becomes very difficult.

Regulations have an arbitrary element but subsidies may be open to the same charge unless grants are made according to well defined formula, as distinct from administrative fiat. In the cultural area, which cities should have subsidized opera or ballet? How much should go to rock groups? How much should go to symphonies?

Subsidies and regulation both have advantages and disadvantages. In many cases, particularly in cultural activities, the efficiency argument against regulation may coincide with a principle but be almost irrelevant in practice: the industry affected may be small and the feedback to other areas of the economy may be infinitesimally small.

Optimal economic policy for the promotion of indigenous culture industries and activities, in the presence of cheaper foreign culture, is difficult to formulate. It is full of pitfalls. If the production of cultural goods and activities were an ordinary industry the infant industry argument - that protection is needed until a certain size has been attained - might be relevant. In the case of culture the infant industry argument cannot be used for two reasons: first, culture has many of the features of public goods and it is difficult to exclude foreign cultural influences from Canada by the price mechanism alone; second, the infant industry argument is based on the fundamental premise that the output of the protected industry will increase and strengthen so the protection can finally be removed and at the old set of prices welfare will be improved. This condition is unlikely to obtain in the cultural sector. The potential economies are not such as to allow an unprotected Canadian cultural industry — even if expanded — to prosper in competition with the overflow of low priced foreign magazines, films, television, and goods of this class. An exception would exist only if the tastes of Canadians were changed by the imposition of the tariff.[10] On balance, the requirement for taxes, subsidies or regulations would continue to exist.

Inefficient policies can also result from a lack of information or a misleading interpretation of statistics or forecasts.[11] There is little concrete information on many facets of nationalism.

Still another difficulty is that costs and compromises are involved in reaching collective decisions; the trade-offs of different individuals and groups vary; differences in knowledge or differences in assumptions about the desirable shape of society or the economy may make compromise necessary, but difficult.

One important step would be to minimize the individual and group cost of moving to new policies by providing adjustment assistance. The most far-reaching presumably is the maintenance of full or high employment during the transition.[12] Also, if the new policy were to avoid making some citizens better off at the expense of others, and if the changes were to be unambiguously an improvement, it would be necessary to compensate those regions, industries, groups or individuals who would lose as a result of the new policies.

Policies other than compensation have been recommended for the transition. If the result of restricting the inflow of foreign capital was a reduction in the income per Canadian, part of the decline could be buffered by a reduction in immigration. It could be argued, however, that in the long run restricting the inflow of labour would not be required: capital inflow restrictions would lower real wages for Canadian labour and this would discourage immigration and, because the rewards from labour would be greater elsewhere, it would encourage emigration.

Income Distribution

In the discussion of policy trade-offs and the consideration of alternative policy techniques, it was suggested that nationalist policies inevitably would have income distribution implications. These policies protect industries and firms and their employees as well as other select groups, much as does a tariff or a quota in the similar case of protecting against imported goods. The costs to consumers rise. Restrictions on foreign capital increase the returns to capital relative to labour in Canada.

Throughout this paper we return frequently to this theme.

Regional, Constitutional and Spillover Aspects

One of the complexities inherent in an objective consideration of any policy designed to increase national independence is that different provinces, and even different regions within provinces, have different levels of economic and cultural development. Policy changes cause gains for some regions, groups, sectors and industries and losses for others. There is a clear danger that a piecemeal approach not only will result in resource misallocation but, in addition will satisfy no one. The danger of such a piecemeal approach is compounded by the fact that authority rests with both the federal and provincial governments. The provinces have a major interest in all areas of economic and cultural nationalism. The Federal Government, however, has taken the lead and the major instrument — the Foreign Investment Review Agency (*FIRA*) — does not have strong support in all provinces. Ontario is considered to be the home of most Canadian nationalists, but the Ontario Government appears concerned about the impact of *FIRA*. The Provincial Treasurer recently stated:[13]

> I am concerned about the overall investment climate both for domestic and offshore investors in Canada, and I am convinced that the public wants stability in the economic environment and that it understands that to move too fast in this area at this point in time would be risky. I am not so sure the Federal Government understands that fundamental mood of the Canadian people.

Concern is even greater in the Maritimes and the west where investment funds from within Canada are alleged to be harder to obtain.[14]

Another difficulty is that the effects of policy changes spill over between jurisdictions. Different regions of Canada have competed to acquire various investment projects. The forms of competition have been numerous and varied, and are often buried in expenditures for roads and other infrastructure that relate directly to wooing of industry. It has been suggested that different provinces, by competing for particular projects, have wiped out any overall net gain from some of these investments. In such a context, a review body at the national level could perform a useful function but, unfortunately, the above scenario lacks credibility — too little knowledge and information about costs and benefits is available. Even to outline a framework for such an analysis is difficult in a world of uncertainty, imperfect markets and a diversity of overlapping policies.

The Council holds the view that it would be better to change across-the-board policies, such as the tariff or competition law (providing adjustment assistance in the interim) and rely less on assessments of individual projects. Subjective judgements at a project level abound because the relevant cost benefit calculations of these projects can only be done most imperfectly.

As noted earlier in this report, Canada has long had policies for national independence in such specific areas as trade. But ownership restrictions have also existed in transportation, electric power, communications and other sectors. These have been specific or have involved public ownership. In recent years the number of restrictions has increased at both the federal and provincial levels. In some cases, governments have indicated their intention of bringing in more legislation in the future.

The following two sections summarize the policies followed to date, briefly assess their economic and non-economic effects and suggest alternative approaches.

Because of the wide ranging fields to which these restrictions apply they are discussed in two sections; foreign investment policies, and cultural policies.

III. FOREIGN OWNERSHIP POLICY

Of all the issues of economic and cultural nationalism, those concerning foreign direct investment, have been debated the longest. The Gordon Royal Commission, the Watkins Report, the Gray Report and the Ontario Select Committee all acknowledged that Canada has grown and developed and received positive net economic benefits as a result of foreign direct investment. They also concluded that, in the process, Canada lost control of some aspects of her own destiny and is vulnerable to decisions made beyond our national borders. Survey and attitudinal data show that questions of control and the economic consequences of foreign investment for such matters as incomes, balance of payments, and employment are of concern to Canadians. Although many Canadians are worried, reliable evidence does not yet exist which shows the total net balance of costs and benefits. Furthermore, when confronted with other concerns, such as inflation or unemployment, the effects of foreign investment seem to be considered less important by most Canadians.

Policies of Canadian governments towards foreign direct investment began to change in 1958 with the publication of the Report of the Royal Commission on Canada's Economic Prospects — a Commission chaired by Walter Gordon. The major policy steps have been as follows:[15]

-1962, *the Corporations and Labour Unions Returns Act* (*CALURA*) allowed the collection of information on corporations and trade unions (a federal policy);

-1966, *Guiding Principles of Good Corporate Citizenship for Foreign Subsidiaries* (a federal policy);

-1967, The *Bank Act* (1967), although not important in itself, the confrontation over the foreign owned Mercantile Bank marked a new stage in the government's determination to preserve Canadian ownership (a federal policy);

-1971, The *Canada Development Corporation* (a federal policy);

-1973, *Foreign Investment Review Act*, to review acquisitions of Canadian firms by foreign entities (a federal policy);

- various acts to restrict foreign ownership in key sectors. These included sales finance firms, the securities industry, periodical and paperback distribution, loan companies, insurance companies, trust companies, television and radio broadcasting (some federal, some provincial);

- requirements that a certain proportion of company directors be Canadian citizens (both federal and provincial);

- amendments to the *Income Tax Act* to influence the allocation of Canadian funds to Canadian investments, as well as to reduce or eliminate tax incentives given to subsidiaries of foreign firms operating in Canada (federal);

- restrictions on industrial or regional development incentives *in certain cases* to Canadian firms (provincial);

- many *ad hoc* regulations or the use of moral suasion (both federal and provincial).

Before proceeding it is worth noting that some Canadian economic policies work in the direction of increasing foreign ownership. Canadian tax, competition, tariff and financial market policies, rather than promoting Canadian ownership, in some respects create an environment conducive to an increase in foreign ownership. For example, if financial markets are not fully competitive as a result of regulatory policies, it will be more difficult to finance developing Canadian firms. Foreign financing and increased foreign ownership will result.

Surveillance, Screening and Guidelines

Given that Canadians are concerned about Canadian independence, setting up an agency to provide screening and surveillance is an obvious step. The surveillance function has largely been conducted under the authority provided by the *Corporations and Labour Unions Returns Act* (*CALURA*).

Improved data were badly needed. There are, however, many difficulties in defining data for the study of particular aspects of foreign ownership. At the same time, given the need to preserve the confidentiality of data for individual firms and the difficulties in defining "control" in minority control situations, little can be done to present data in a readily usable form. Nonetheless, some of this information is available for government economists, royal commissions, and, generally, those prepared to do more fundamental and intensive research. The *CALURA* group have also been extending their coverage into new areas where information is required.

The Federal Government's *Guidelines of Good Corporate Behaviour* were issued to encourage firms to increase their contribution to the Canadian economy without coercion, but without assessment of the effects of the twelve guidelines. In many cases the guidelines only amount to being "good business" and the procedures advocated would probably be followed in any event. Nonetheless, they serve a purpose in outlining what is expected of foreign based firms operating in Canada. The complaint is often heard that business does not know what is expected of it and that entrepreneurs and businessmen only want a stable framework that enables them to operate and to plan for the future, free of changes based on the whims and fancies of governments. It is also often alleged that managers of subsidiaries in Canada do not have the freedom to pursue prudent, rational and profitable economic business strategies because of head office rules and interference. In such a situation the guidelines act as a reminder to parent firms and provide support for the activities of subsidiaries. The guidelines have recently been revised and reissued as *New Principles of International Business Conduct.*[16]

Viewed from the perspective of the economics of the guidelines, it is safe to say that in some cases the goals cannot reasonably be expected to be reached because of the present industrial structure. For example, how can you ask a foreign subsidiary to sell on world markets if it was drawn to Canada by the tariff and the prospect of selling at high cost with a sub-optimal scale plant?[17] While the scale allowed by the protected but growing Canadian market is increasing, it will not support plants in some industrial sectors of a scale that enables vigorous competition with foreign firms in export markets.

Imports are another consideration. Subsidiaries of foreign firms operating in Canada import more of their requirements than Canadian firms.[18] To the extent that developing lower cost domestic suppliers is a learning process for new subsidiaries, the guidelines

could provide a spur. On the other hand, there are many other reasons for the proportion of imports by foreign subsidiaries — e.g. bulk discounts and technological needs. In these circumstances, guidelines have limited relevance as a means of improving import performances or even setting a standard.

The Federal Government's *Foreign Investment Review Act* and its operative arm, the Foreign Investment Review Agency, were initially recommended in the Gray Report. The *Act*, which came into effect in 1974, was "to provide for the review and assessment of acquisitions of control of Canadian business enterprises by certain persons and of the establishment of new businesses in Canada by certain persons."

The object was the maximization of the net benefits to Canada. In other words, the objective was to improve the "terms of trade" — lower the relative price that Canadians pay for foreign direct investment. Initially the legislation dealt only with the takeover of firms. It was recently extended to cover the establishment of new businesses unrelated to the existing industrial activities of a firm in Canada, as well as the establishment of new businesses by a firm not already operating in Canada. It is currently the most ambitious as well as perhaps the toughest screen for foreign investment in the Western industrial world. This is principally because of the requirement that firms show a significant benefit to Canada. The operations and assessment procedures are complicated. They cannot be described in full here. The first step is to determine whether the individuals or corporation involved are foreign. The application of the *Act* also requires a decision on the location of control, and a determination as to whether a business is "new" or "related". These are contentious issues. As well, there are minimum size qualifications; and only if they are exceeded is the *Act* operative.

The *Act* has, as its overall test, the provision of a significant benefit to Canada, rather than merely bringing no harm. The following factors are to be taken into account:[19]

a) the effect of the acquisition or establishment on the level and nature of economic activity in Canada, including the effect on employment, on resource processing, on the utilization of parts, components and services produced in Canada, and on exports from Canada;

b) the degree and significance of participation by Canadians in the business enterprise or new business, and in any industry or industries in Canada of which the business enterprise or new business forms, or would form, a part;

c) the effect of the acquisition or establishment on productivity, industrial efficiency, technological development, product innovation and product variety in Canada;

d) the effect of the acquisition or establishment on competition within any industry or industries in Canada; and

e) the compatibility of the acquisition or establishment with national industrial and economic policies, taking into consideration industrial and economic policy objectives enunciated by the government or legislature of any province likely to be significantly affected by the acquisition or establishment.

In practice, and as intended by the government, *FIRA* has not operated merely as a screening agency. It has taken part in a bargaining process with the objective of increasing

the benefits to Canada, while reducing the costs. It has apparently withheld approval until more jobs, investment and exports have been promised by the firm in question.

There are a number of difficulties with *FIRA*. Many stem from the basic goal — to improve the benefits Canada receives from multinational enterprises. As suggested above, there are many trade-offs in arriving at screening decisions and these differ by industry, sector, region, occupation and other variables such as income and wealth.

First, although the terms of reference for significant benefits give some indication as to whether or not a proposed takeover is acceptable, the actual process is clouded in uncertainty. The public at large is not given sufficient information as to why the decision is considered to be in the public interest.

There are a number of aspects of this problem. One is that there is little likelihood of consistency across projects or time periods. For example, the Federal Government's interest in foreign investment increases during periods of unemployment. This makes it likely that a takeover proposal, which was rejected in a good year, might be judged better, by the normal criteria used, than a poor takeover which might be accepted in a year of weak economic activity.

Another problem concerns provincial needs and preferences for alternative sources of scarce capital. Some provinces rely largely on foreign finance because, for various reasons, indigenous investment sources are considered to be inadequate.[20] The same is true regionally.

The criterion of the existence of positive net benefits gives no indication of the benefits that might accrue from alternative uses of Canadian resources. For example, a firm could demonstrate that a takeover would increase exports, employment and investment. However, if this takeover resulted in a reduction of competition in that market or if the corporate objective was to benefit from a tariff wall, Canadian welfare probably could be better served by importing at lower world prices and using the resources saved to produce a greater amount of goods that Canada could produce efficiently. This would not only reduce foreign ownership but would also meet the complaint of some multinational corporations that they are asked to produce and export from high cost markets rather than export to such markets.

To reiterate an earlier point, increasing net benefits will have more pronounced benefits for some while concurrently being harmful to others. These income distributional aspects may well be important, but they are difficult to weigh in making decisions.

It is also difficult to appraise the effectiveness of *FIRA*, not only because of the lack of information on potential takeovers which have been reviewed, but because the screening process itself may have discouraged a number of firms which felt that they might not be able to satisfy the criteria. There appears to be a good deal of uncertainty in the business community as to the nature or extent of the "significant benefits" required. Furthermore, uncertainty, even in the case of a bid likely to be successful may affect the price or terms of the takeover to the detriment of the Canadian sellers. Key management or research personnel might leave for other firms and, indeed, might join existing and expanding multinationals.

A further difficulty is that by looking at each firm individually, *FIRA* does not look at such macroeconomic concerns as interest rates or the exchange rate. These effects may change the cost-benefit calculations considerably.

It is not widely recognized that the *Foreign Investment Review Act* restricts competition in the market for assets. It taxes Canadian holders of wealth who may find it necessary to sell their assets at a reduced price because of the existence of the *Act*. If a firm is already foreign owned, *FIRA* may deter it from being sold to Canadians because of the drop in asset price.

Although arbitrary rules are often less efficient than discretion, in the absence of public disclosure there is no reason to believe that the discretionary authority exercised by *FIRA* is to be preferred to alternative policies. The primary requirement is openness. As it stands *FIRA* wields arbitrary authority opening the possibility of inconsistency among investments, regions and over time. There is a serious need for more disclosure and more public scrutiny of *FIRA's* activities.

One low cost way to improve the performance of *FIRA* is to raise the minimum size of transaction that is subject to review (and index this limit with respect to price changes) in order to restrict its activities to a smaller number of more important cases. Monitoring of past cases should also be expanded to include a re-evaluation where *FIRA* has rejected a proposal.

Greater disclosure is unlikely to be popular with some businessmen. It may affect such things as markets, the cost of a takeover or expansion, the employment of key personnel or it may prejudice the confidentiality of information. Is this an acceptable price for greater consistency? One partial solution would be for *FIRA* to spell out more fully the reasons for its decisions. It must be recognized however that complexities of the issues do not permit simple answers.

Prohibiting or restricting foreign ownership in certain "key sectors" is an example of the use of a rule, rather than discretion, in the screening of foreign investment. The prohibition or restriction technique is explicitly used for many financial intermediaries and radio and television stations. Because many crown corporations in Canada are monopolies and because government has conferred monopoly power on certain firms — public utilities or transportation — *de facto* restrictions on foreign ownership exist in these sectors. Since it depends upon many other factors for success the key sector approach seems far from ideal.

The main administrative problem is in specifically designating where a key sector begins and ends and specifying the rules in law. The economic problems, however, are those related to efficiency and income distribution. Where entry of new firms to an industry is restricted, firms already in the industry have little incentive to be efficient or may earn higher profits than efficiency and competition would support.

Tariff Policy

One of the most elementary observations about foreign ownership in Canada, including the general position of multinationals, is that their presence is usually associated with trade barriers. Canada's position, as one of the more highly protected (in tariff terms) industrial nations of the world, dates back to the National Policy of 1879.[21] The move to the common external tariff in the European Community marked the beginning of a major move by multinational firms into European manufacturing. It is important to recognize that the

desire to promote domestic manufacturing, through the agency of trade protection, has been thought of as a policy to promote independence with respect to production in order to create employment. Yet, because foreign firms came to Canada to produce largely because of the tariff, it resulted in a substantial increase in foreign direct investment which some associate with a loss of Canadian political and social independence.

The induced inflow of foreign capital is only one aspect of the tariff. There is also evidence that the tariff has reduced the scale of output of manufacturing industries in Canada, has led to short production runs and has resulted in a far from optimal degree of specialization.[22] In a study of average plant sizes in six countries, Canada placed at the bottom, well behind Germany, the United Kingdom and the United States.[23] Within plants, the length of production runs in Canada has been shortened by a small sheltered market; longer, more efficient runs are not practicable. The tariff has allowed firms to charge higher prices and so support operations that otherwise would have been uneconomic. The higher prices and reduced efficiency are reflected in a reduced level of per capita income in Canada.

The Economic Council of Canada has presented a series of recommendations, based on substantial research, that, if adopted, would move Canadian commercial policy in the direction of free trade.[24] Their recommendations applied to the agricultural sector but excluded crude oil and natural gas. Consistent with the comment in this report, they also emphasized the importance of maintaining full employment during the period of transition.

The Economic Council recognized that during the adjustment period, as Canada was moving in the direction of free trade, rationalization might result in some increase in foreign ownership. Over the longer term the ratio of capital used to output in Canada would decline as efficiency increased. Currently the capital to output ratio is much higher in Canada than in the United States as a consequence of our smaller scale plants and shorter production runs. Such a restructuring would reduce the capital needs of Canada. Furthermore, as Canada became more productive, domestic savings would grow more rapidly.

The Ontario Economic Council endorses the work and recommendations of the Economic Council of Canada as they pertain to national independence, and is fully conscious of the further resulting benefits which could accrue to Canada as a consequence of their proposals. The Ontario Economic Council is concerned that the world economic environment is becoming less favourable to Canada: this is partly a product of the size of the domestic or "trade bloc" markets of our major competitors and partly a result of the unacceptably slow growth of productivity in Canadian industry.[25] Trade liberalization would help to remedy both deficiences. It would also remove one of the major incentives for foreign firms to come to Canada.

Would freer trade reduce Canadian political autonomy? The evidence suggests otherwise. It does not support popular opinion on this subject.[26]

The formation of the European Free Trade Association resulted in a substantial increase in trade but only trivial political measures in the direction of integration. This was also true of the Anglo-Irish Free Trade Association and the New Zealand-Australia Free Trade Association. In the case of Canada, political autonomy has already been reduced by United States trade policy; this constraint would be eased by a movement towards free trade.

Competition Policy

It is commonly assumed that foreign investment by multinational corporations is associated with imperfect competition. This may take the form of horizontal or vertical integration, product differentiation or the ownership of some asset, such as technology, patents or trademarks, that is unique to the firm. It is also alleged that the multinational achieves an advantage because of the difficulty of entry of other firms, due to high capital costs and a large capital requirement, economies of scale, pooling of risks, access to technology and other causes. Conversely, it has been suggested that foreign subsidiaries may create competition by entering a market, particularly if they have some cost advantages which force those firms already in the market to become more efficient. With the movement of American and other multinationals into Europe, especially after the formation of the European Economic Community, European businessmen often complained that the Americans did not understand the comfortable nature of the heavily cartelized structure of business there.

Research has shown that over the period 1954 to 1964 there was no readily apparent relationship between changes in the degree of industrial concentration in Canada and changes in foreign control. It is true, however, that foreign controlled firms tend to be larger than Canadian controlled firms: foreign capital establishes or buys into the larger firms in each industry although "there is no evidence of a tendency to seek out the more concentrated industries."[27] Over the same time period there was a decrease, on average, in the importance of foreign control among the leading firms.[28]

Further evidence has shown a tendency, albeit a weak one for profits in Canadian manufacturing industries to vary inversely with the share of sales attributable to foreign subsidiaries in the industry.[29] In other words, the greater the sales by foreign firms the greater the encouragement to competition. The result is reduced profits. This only obtained for concentrated industries. No such relationship is evident for unconcentrated industries or in those in which sales of foreign subsidiaries are a small proportion of the total. There is also evidence that the shares of sales made by foreign firms in Canadian manufacturing industry are associated with the intensity of advertising and research in the industry.[30]

Other evidence has shown that a high tariff and a high degree of concentration only affect relative prices when both are present.[31] In the presence of both, Canada's production prices tend to be 7 to 12 percent above their U.S. equivalents. This study also showed that, whereas concentration has a significant positive effect on gross profit per unit, the Canadian tariff does not. It suggested that tariff policy changes would have only a transitional influence on profitability.

This Council considers that mergers and takeovers are a source of concern because there is a possibility that competition will be restricted in the process. During the screening of acquisitions under the *Foreign Investment Review Act*, applicants are warned that information provided in the application may come to the attention of the Director of Investigation and Research under the *Combines Investigation Act*. In screening takeovers, *FIRA* obtains advice on the impact on competition of the acquisition. As we mentioned earlier, however, as long as the public does not have adequate knowledge of the decision processes and the rules under which the *FIRA* Agency operates, it remains uncertain how well the public's interests are served.

The *Competition Act* is being amended. Many of these amendments impact, or will impact, on foreign ownership questions. The problems of evidence and legal proof are great and restrictive business practice convictions are difficult to obtain.

Competition policy is a complicated and contentious area of law and economics. The Council wishes to emphasize two basic points. First, more competition is needed in Canadian industry and foreign entrants are a primary source of competition. The lack of competition is related, to a significant extent, to trade restrictions. To restrict the entry of foreign firms, although it might be warranted in many particular cases, would be wrong in general because it would reduce competition. To restrict their entry without reducing trade restrictions, probably would have an unfavourable effect on Canadian economic growth and development.

Second, emerging competition policy, as reflected in law and practice and in the decisions of the Foreign Investment Review Agency, must be carefully watched and audited to ensure that the net effect is not to reduce competition by reducing the entry of foreign firms.

Financial Markets

The inadequacies of Canadian financial markets are often cited as a cause of some of the loss of the domestic control of industry in Canada. Generally speaking, although the reports resulting from major examinations of foreign investment have mentioned these issues, they have never tried to document their validity. The lack of institutions that supply venture capital, conservative banking practices, the relatively large flow of funds into contractual savings, and the investment practices of the recipient institutions — all have been blamed. Stock markets are not used fully, it is alleged, because the lack of volume and liquidity reduces the likely return from secondary trading and further, it is charged, the brokerage community charges too much for underwriting services. The Council is currently engaged in research on these areas.

a) **Chartered Banks**

As mentioned earlier, much of the financial industry in Canada has been designated as a key sector, protected from the entry of foreign firms. Chartered banking is one example. Experience in the banking industry illustrates many of the inadequacies of the key sector approach, particularly in a federal country such as Canada. The *Bank Act* of 1967 sharply limited the operations of the foreign-owned Mercantile Bank and restricted future investments by foreigners in banks in Canada to ten percent. In retrospect, the handling of foreign banking probably is questionable.

The Federal Government failed to achieve its purpose with respect to the entry of foreigners into banking in Canada. Foreign banking operations have expanded in Canada under provincial jurisdiction.[32] Banking business conducted under provincial legislation by foreign banks lacks the safeguards incorporated in normal bank control under the federal *Bank Act*, administered by the Bank of Canada, the Inspector General of Banks and the Minister of Finance. The present situation has also provided foreign banks with a competitive advantage over Canadian chartered banks; this is inequitable, because foreign banks do not maintain reserve requirements with the Bank of Canada, nor are they bound by the restrictions that limit the business activities of Canadian chartered banks.

Moreover, although the *Bank Act* followed some of the recommendations of the Porter Royal Commission — a blueprint for competition in financial markets — some aspects of competition were short lived. Increasing foreign bank competition probably would have made Canadians better off. This is particularly true on the deposit side, especially for small volumes of funds. In any event, the Mercantile Bank was very small by Canadian banking standards and efficiency may well have increased as control shifted from its Dutch owners to the First National City Bank of New York, one of the world's largest banks.

One consequence of the restrictions on foreign banking, with legal and economic barriers to domestic entry to the industry, is that banks probably tend to ration loans by assessments of risk rather than through interest rates. Because foreign subsidiaries are less risky than new and unproved ventures, Canadian entrepreneurs may be forced to look elsewhere for funds. This tends to increase foreign ownership.

The *Bank Act* will be revised within the next few years and the Council suggests that a close look should be taken at increasing competition by permitting increased foreign banking operations within the provisions of the *Act*. Foreign banks should be regulated by the same rules and procedures as the existing chartered banks. The co-operation of provincial governments must be solicited, because foreign banks currently operate under provincial legislation.

b) **Securities**

In the Securities Industry in Ontario there are a large number of firms, yet the industry has sought to be designated as a key sector. The *Report of the Committee to Study the Requirements and Sources of Capital and the Implications of Non-Resident Capital for the Securities Industry* recommended in 1970 that "in our view, the reasons which support the treatment of the securities industry as a key sector are at least as pursuasive as those which support such treatment of many of the other financial institutions."[33] This committee, composed of securities industry executives and an outside chairman, reported to the Investment Dealers' Association of Canada and to the Canadian, Montreal, Toronto and Vancouver Stock Exchanges. It concluded that increased non-resident control over the Canadian securities firms can be avoided only through a prohibition, effective from the date of publication of the report, of any investment by foreign securities firms in any Canadian firm which is a member of any of the self-regulatory organizations.[34] Subsequent amendments to the Ontario *Securities Act* provide a statutory basis for the committee's recommendations.[35]

Once again, although entry is easier than for banking, the markets are less than fully price-competitive. In Canada, the fees of investment brokers are listed and are charged by all brokers. In the United States the New York Stock Exchange moved to a negotiated commission system. In response, Ontario dealers considered price competition for six stocks listed on both Canadian and U.S. exchanges and finally decided to stay with their initial fee schedule — they did not allow price competition.[36] The Council believes that restricting foreign competition in this industry is not in the best interests of Ontario or Canada. In particular, it would seem to inhibit the development of Canadian-owned industry in other sectors, and to take insufficient account of the effects on the structure of competition in the securities industry itself.

One other point should be made. The two cases mentioned in this section do not favour a key sector approach. This is not to deny that, where there is freedom of entry and a competitive Canadian market, such a policy may not be appropriate, given the apparent goals of Canadians. This approach, however, cannot be an efficient way to regulate foreign ownership in the absence of a clear understanding of the industrial structure in the sector, and the adoption of provisions that would ensure continuing entry into the industry and effective competition.

c) **Canada Development Corporation**

In response to the foreign ownership issue in general, and financial market aspects in particular, the federal government brought the Canada Development Corporation into being. The performance of the Canada Development Corporation (CDC) is difficult to interpret. In the 1974 *Annual Report* the corporation stated its objectives as follows

> To develop and maintain strong, Canadian controlled and managed corporations in the private sector. To widen the investment opportunities open to Canadians. To operate profitably and in the best interest of all the shareholders.

The justification was largely based on alleged capital market deficiencies. The CDC was to finance large scale, consortia-type projects where existing Canadian financial facilities were thought to be inadequate. It was also to undertake a venture capital role to bridge the gap between the infancy and maturity of promising Canadian firms. The federal government and the directors have publicly stated that the CDC terms of reference were designed to help develop the private sector and to create a profitable institution capable of competing for the savings of Canadians. The main concern expressed in public has been that the nature of the goals is vague and questions have been asked as to whom the firm was really responsible.

To date the CDC has acquired crown corporations, such as Polymer, purchased a minority position in Texas Gulf Sulphur, purchased a minority interest in venture capital firms, acquired a position in a petroleum company, and participated in a number of firms, such as Connaught Laboratories. The CDC has been criticized for not buying back Canadian firms from foreign owners, for not adequately running firms in which it has an interest, and for having investments in such countries as Belgium, France, Germany, the United States and Australia.

Tax Policy

Tax policy, in Canada and in foreign countries, almost certainly has a major influence on foreign direct investment. Moreover, increased tax revenue is an important benefit received by a country from its resident foreign subsidiaries. At the same time it is often alleged that the multinational corporation, by operating in a number of countries, is able to minimize its tax payments through the location of its operating units or by transfer pricing.

In practice, trying to unravel the tax liabilities of a large multinational is extremely difficult because there are different accounting practices and tax laws in different countries. It is not only the tax rates themselves that differ, but also the treatment of

depreciation, inventory valuation, value of assets, bad-debt allowances, reserves, and many other accounting variants. Many U.S. multinationals require that their foreign subsidiaries keep two sets of books: one set correspond to U.S. accounting practices and one to the accounting practices of the country in which the subsidiary is resident.

Because this field is complex, we are only able to raise a few issues. The first issue to consider is the maximizing of Canadian benefits from foreign investment. Because of foreign direct investment, a country may gain from movements in the terms of trade, from productivity growth — domestic labour has more capital to work with — from external economies and from the taxation of the income from foreign investment. Against this must be set various economic costs as well as social and political costs.[37] It is difficult to conclude a *priori* whether foreign investment is beneficial, but the ability to tax foreign capital is one important positive benefit. Alterations in the rate of tax can improve or reduce the benefits. The problem for the policy maker is to choose a rate to maximize the benefits, keeping in mind the long term needs for capital, technology, management and the like. This is not entirely within the ability of an individual country, because foreign investment usually is affected by tax policies in a number of countries. The higher the foreign tax credits of the capital exporting country and the higher the rates of tax in other countries, the greater the tax the Canadian authorities can levy to increase the benefits to Canadians.

Usually, where a multinational is liable for United States taxes on the income of a Canadian subsidiary, their US tax liability is reduced by the amount of the taxes paid in Canada on the same revenue. This is known as the principle of capital export neutrality; it is designed to reduce the effect of income taxes on the allocation of investment between countries. This has lead some observers to note that Canadian corporation tax cuts, such as the reduction in 1973 to forty percent, applicable to manufacturing firms, merely redistributes tax revenue from Ottawa to Washington, as it applies to U.S. subsidiaries in Canada. As well, Canadian tax incentive policies designed to encourage investment, have a reduced impact because of the extent of the operations of subsidiaries of United States firms.[38]

The Carter Commission defined these issues but felt that it "is of vital importance that Canada avoid taking actions that would lead the United States. . .to reduce their foreign tax credits, for this would force Canada to reduce its tax revenue from this source if it wanted to maintain the capital inflow."[39] In the present circumstances, and given the many tax changes that have taken place, the Council feels that more consideration should be given to the extent to which the existence of foreign subsidiaries reduces the effectiveness of tax policy as a stimulant of investment. As well, the extent of revenue losses from tax changes should be looked at with a view to assessing their magnitude and their effects on fiscal policy and income distribution.

The second area of concern is transfer pricing, although this is not unique to foreign owned firms. The transfer prices which concern us here are accounting prices, used for exchanges of goods and services between affiliates across national boundaries. Tariff liabilities and taxes may be reduced in particular jurisdictions by the choosing of appropriate prices. Alternatively, funds may be implicitly transferred without a corresponding capital flow. Canadian owned multinationals, as well as foreign owned corporations, may benefit by such manoeuvers. The Revenue Department has estimated

that losses from Canadian owned companies shielded in foreign tax havens, amount to several hundred million dollars a year.[40] The implications are wider than merely the tax revenue loss, however, because purely domestic firms are placed at a disadvantage and the choice of domestic versus imported materials, services and other inputs is influenced.

The problem extends beyond goods to all manner of transactions which are not 'at arm's length'. The Ontario Government, in its 1973 Budget, introduced what is, in essence, a withholding tax on "management fees, rents, royalties and similar payments to non-residents with whom they do not deal at arm's length."[41] This received substantial criticism on the ground it contravenes basic tax principles in not recognizing legitimate expenses necessary to the earning of income. Furthermore, in many cases foreign tax credits would not apply and double taxation could result. It may pose difficulties because the Federal Government has international agreements with many other nations with respect to withholding taxes. In contrast, the OECD model tax treaty states that royalties shall only be taxed in the recipient country,[42] although recent Canadian tax treaties have allowed a low maximum federal tax.[43]

If the provincial government was concerned about the inappropriateness of some of the transfers involved, the normal auditing procedure would have been preferable to a tax with the above disadvantages. Although the Council recognizes the difficulties of valuation and taxation of transactions which are not at arm's length it recommends that the Government of Ontario take note of the jurisdictional difficulties and the undesirable features of this tax. The Council also feels that the Federal Government, in its current reform of commodity taxes, should give further attention to the problems of transfer pricing. The Council currently has a research project underway on this subject.

The third area of concern is mining and resource taxation. Historically, Canadian development has relied heavily on the exploitation of natural resources. Until very recently the effective tax rate on these firms was low and, in addition, governments at all levels provided assistance through the provision of town sites and infrastructure. Natural resource companies are now caught between Federal and Provincial tax authorities and their effective tax rate is higher than for manufacturing corporations.

One reason for the recent increase in taxation has been the argument that once a non-renewable resource is extracted and exported it is lost to Canada. This is compounded, in the case of foreign mining firms, where the net benefit to Canada is difficult to determine because of the outflow of dividends from the domestic subsidiary to the foreign parent. In the case of Canadian owned mining firms, the dividend benefits from the resource at least stay in the country. It should not be forgotten in this comparison, however, that foreign firms may bring to Canada savings, technology and management, all of which must be compensated. Another consideration is that when in the ground, resources earn zero interest and produce no jobs or income.

This issue is complex, like most of the issues discussed in this report. While the Council feels that there may be a case for differential tax treatment of the mining industry, it is far from obvious what the level of taxes should be. The concept of economic rent is difficult to quantify for tax purposes. Is there also a case for differential tax treatment of foreign owned mining firms? The Council is currently sponsoring a study on this question.

One final point to note is that the tax system has discriminated against equity investments by Canadians. The integration of personal and corporate taxes recommended

by the Carter Commission would have taxed income from all sources at the same rates. Corporate income would only be taxed once.[44] This would have encouraged investment in Canadian corporations by Canadians and lowered the cost of capital to these firms. Tax changes since the publication of the Royal Commission Report have not incorporated this proposal. The Council feels that, if Canadians are concerned about foreign ownership, the tax system could be adjusted to encourage equity investment by Canadians.

Research and Development

Because of the "package" nature of foreign direct investment — incorporating, for example technology and management — the costs of acquiring these services separately are important issues in the development of Canadian owned industry.

Canadian technological performance has been poor compared to that of other industrial countries.[45] The importance of private industry can easily be seen. Canada is one of the few countries where less than half of the total research and development expenditures occur in industry.[46] Furthermore, Canada does relatively more research and less development than most other industrial countries.[47] The federal government, on the other hand, has played a major role in performing research, in its own development work and in financing both.[48]

The economics of the allocation of resources to research and development are complicated. Poor Canadian performance has often been blamed on the important role of multinational firms in Canadian industry.[49] One reason is that these firms may simply import the technology, or they may do some research here but develop the technologically-based products elsewhere. It is also argued that they may increase the drain of skills from Canada and stifle domestic research.

On the positive side, knowledge and technology have been instrumental in increasing productivity. Furthermore, the ability to import technology allows the economies of scale that are made possible by income or market growth to be exploited more quickly. A further advantage of imported technology is that it creates spillovers into the domestic sector because it is impossible for a firm to capture all of the benefits of training and research. Another benefit comes from the encouragement to domestic firms to expand their technological base.

We do not know if the cost Canada pays for technology imported by multinationals is appropriate because these are usually transfers within a company at non-market prices. A few companies do not charge their Canadian subsidiaries for technology, but merely recover the firms profits. In other cases, the cost of the transfer may be much less than if it were purchased on the market. Furthermore, the taxation authorities in Canada and abroad presumably scrutinize these costs.[50] On balance, it seems that the money cost of the acquisition of foreign technology is unlikely to be disproportionately high.

Governments have played a major role in stimulating Canadian research and development. There are two theoretical justifications: governments bear risk at a lower cost than individuals or corporations and, further, knowledge is difficult to produce and sell because it can easily be appropriated by others. As a result private firms do not invest sufficient resources in research and development in the absence of government intervention.

The federal government has a number of programs of assistance, designed to stimulate research and development.[51] The Ontario government has also played a relatively small role since, in 1928, it joined with the Canadian Manufacturers' Association to found the Ontario Research Foundation.[52]

Much of the demand for subsidization of research and development, or more active government intervention in R & D has understandably, come from scientists and those who would benefit from the provision of more white collar jobs. Yet the payoff from the availability of subsidies and their proper allocation is not obvious. If the payoff is low, subsidies would not be for research and development, but for scientists. Once again income distribution implications are relevant.

The Council is concerned about the poor performance of Canadian industry in this area and is currently engaged in a research program to suggest appropriate policies. The questions posed are contentious. How have existing subsidies performed? Should subsidies discriminate against foreign firms? Should subsidies contain "work in Canada" provisions? Should subsidies favour export industries? Who gets the subsidies? Do subsidies increase the resources going to R & D or merely subsidize projects which would have been conducted in any event?

Other Industrial Policies and Issues

Foreign investment questions involve virtually all aspects of economics and all areas of industry. This section deals with some of the residual issues.

In 1972 the Government of Ontario required that the majority of directors on the board of an Ontario corporation be Canadian. The federal government intends to follow suit. This is no doubt a popular move, and one which can have obvious advantages in making foreign parent companies aware of the economics and domestic interests of the country in which their subsidiary operates. On the other hand, is such a requirement really necessary? Presumably a foreign firm is already at a disadvantage by virtue of differences in legal systems, customs, labour relations and personnel policies and, most important, such marketing activities as distribution, transportation and advertising. It would be surprising if such a firm did not acquire substantial local advice at a senior level.

Another factor is that most multinationals have integrated operations, especially in manufacturing. In such circumstances foreign representation, on some scale, is likely to be needed for efficiency. On the other hand, it could be argued that a dominant Canadian board is needed to influence an integrated firm to allocate more favourable decisions towards the local subsidiary. But if the company is trying to maximize its profits would they not act in a rational manner in any event?

Many of the remaining current policies in the industrial field are restricted to particular sectors, industries, regional policies or inequities or inconsistencies between Canadian and foreign laws. In Ontario, certain types of regional incentives have not been available to foreign owned firms. Because the effectiveness of many regional programs are themselves open to question, it is difficult to pass judgement on the exclusion of foreign firms from such programs.

Since July, 1975, all northern resources development projects carried on under Federal

jurisdiction have been required to have the Canadian content approved by an advisory committee. The goal of 90 percent Canadian content was set and exceptions are allowed only if it can be shown that there is not a competitive Canadian owned or controlled firm which can supply the specific project requirements.

One potentially important point should be noted. The fact that multinational firms can, under certain circumstances, be highly efficient engines for economic development, together with the possibility of international conflicts over tax policy, anti-trust laws, capital flows, and so on, has suggested to many that governments should use their authority and coercive power to resolve disputes. At the moment, the OECD and a number of United Nations groups are studying the implications of multinational corporations. One authority has recommended a "GATT for investment" to function much the same way that GATT does in helping to resolve international trade disputes.[53]

The failure of international organizations to deal effectively with less complicated questions does not encourage high expectations. An international approach would likely compound the domestic difficulties attributed to *FIRA*, and remove decision making even further from those that bear the impact of the decisions. It should also be pointed out that Canada is not a party to the OECD Code of Liberalization of Capital Movements, even though it is a member of the OECD.

The OECD's attempts to standardize international statistics on direct investment and multinational corporations is encouraging and deserves strong support.

Land Ownership

The non-resident and foreign ownership of land has become an issue in recent years. The Select Committee has issued an interim report on *Foreign Ownership of Ontario Real Estate*.[54] and public policy in Ontario and other provinces has been moving to restrict the property rights of non-residents of Canada. There is also a trend to restrict the rights of Canadians to own property in provinces other than the one in which they reside.

The reasons for government concern about land ownership are not difficult to comprehend. Property and real estate values generally rose rapidly during the acceleration of Canadian and world inflation. This was partly attributed to the tax treatment of real property and partly to the desire to hedge against inflation. Superimposed on these phenomena has been the trend toward owning vacation homes — a function of the rising standard of living and increased leisure time. The growth of population is another contributing factor.

These factors have been as evident in other countries as in Canada. Much of the concern in Ontario has been with recreation land. Many Americans live in a much more densely populated environment than Canadians and the appeal of the lower population density in Ontario has contributed to the strong demand for real estate here, particularly in "vacation" areas.

In southern Ontario as a whole there are about 155 persons per square mile. This compares with 381 in New York State, 260 in Ohio, 262 in Pennsylvania and 199 in Illinois. The corresponding density in Northern Ontario is 67.[55] On the other hand, some U.S. states have densities comparable to that in southern Ontario such as Michigan at 156 — or even lower than southern Ontario — such as Minnesota at 48 or Wisconsin at 81.

Density is only one factor in determining the demand for recreational property and Ontario vacation real estate, although clearly an important one. Price, services, environment, and access all play a role.

Foreign demand for real estate is important. The economic determinants are the usual business considerations, plus the expected appreciation in the value of these assets and changes in the exchange rate. Although statistics are sparse, it appears that in the Toronto area a great deal of commercial property is owned by foreign interests. Foreign interests also own a substantial amount of land destined for residential development in the area surrounding Toronto.

In April of 1974 the Ontario government introduced the *Land Transfer Tax* and the *Land Speculation Tax Acts* to slow the rise in land prices.

In the case of the Land Transfer Tax, the foreign demand for Ontario real estate is to be dampened by a 20 percent tax on the purchase price.[56] Estimates place the foreign control of Canadian real estate at about 5 percent,[57] although the share is much higher in particular areas or sectors of the market. Exemptions to the Act may be granted for developmental or industrial uses by the Cabinet. Consequently, the effects on the future flow of land to the market are difficult to predict.

The Ontario Land Speculation Tax was also designed to reduce the rewards from land speculation and to flatten the rise in land and house prices. Certain restrictions in the *Act* discriminate against foreigners. Most notably, the exemption for a principal recreation property (including up to 20 adjacent acres) only applies if the disposition is to a Canadian resident.[58] The *Act* appeared to be aimed primarily at speculation and not at foreign buyers as such.

In a related development, the Supreme Court of Canada recently upheld a Prince Edward Island law restricting the non-resident ownership of land.[59] There were concerns that the law discriminated against foreigners. But the law restricts all non-residents including those from other provinces. It was argued also that it transgressed a federal prerogative. Significantly, the remaining nine provinces supported the stand taken by Prince Edward Island.

The Council is aware of the wish of many Canadians to purchase vacation property at reasonable prices. There is also concern with soaring real estate prices for residential and industrial use. The Council realizes that much of the demand, both foreign and domestic, has been associated with an accelerating inflation and a desire to hedge against it. It is obviously to be hoped that this phase is over, but great uncertainty remains. It is apparent, however, that there will be a growing demand by Ontario residents for Ontario property. Because provincial policy in Ontario, and the rest of Canada for that matter, appears to be set on a path of restricting *non-resident* ownership, the Council wishes to emphasize the need for better statistics on this subject and some in-depth research on the effects of the demands of non-residents for Ontario real property.

IV. CULTURAL INDEPENDENCE

Canadians seem to be as concerned — perhaps even more concerned — with cultural independence as they are with foreign ownership. Notwithstanding the sincerity of the concern or the range of the difficulties, the fundamental reality of the situation must be defined and acknowledged. Canada is a nation of 22.7 million people, of whom roughly 6 million have French as their mother tongue. This leaves less than 17 million English speaking Canadians, most of whom reside at intervals along a strip several thousand miles long and extending more or less, one hundred miles north of the American border. In most areas of Canada the population density is very low.

On the south side of the border there are over 210 million Americans. On average, Americans have a higher income per head and a lifestyle — admired by many Canadians though disliked by others. Many of the latter are strong nationalists. They seem to be predominantly located in the richer provinces, especially in Ontario. This contributes to conflict or misunderstanding. There are those, such as many in southern Ontario, who have achieved a level of personal income and standard of living that may allow the luxury of improving the quality and distinctiveness of their lives. But there are others for whom this is less true. Throughout Canada, including the less developed regions of Ontario, there is criticism of the fact that Ontario nationalists, like others with above average incomes, are advocating policies that would erode the probability of the "have-nots" achieving a standard of living equivalent to that of many of the nationalists.

The distinctive element of many cultural activities is their general availability: the consumption of a cultural activity by one person does not, by and large, reduce the amount available to another. Radio and television are examples. If Canadians watch television programs broadcast in the United States and intended for American audiences, or listen to U.S. radio stations the money cost to Canadian consumers is zero and the U.S. listeners incur no cost. Given that most people in Ontario live in close proximity to U.S. radio and television stations, they are bound to receive a variety of U.S. programs at zero cost. In contrast, with an English language population of 17 million, Canada cannot provide equivalent programming except at a very high cost. Most Canadian media industries face similar problems.

Publishing

The economics of publishing is more or less similar to that of broadcasting. The cost of increasing publishing output declines steeply as the volume of printing output expands. Consequently, it is difficult to compete with U.S. publishers. To provide editorial copy and technical services for a Canadian edition of a U.S. publication probably involves less cost than establishing a Canadian magazine for the small Canadian market. More generally, Ontario residents can import most magazines, books and journals and, in particular, specialized ones, more cheaply than they can be produced for the small Canadian market.

On a broader scale, to provide Canadian music, theater, ballet, museums and related cultural facilities to our small population particularly in small to medium sized or isolated communities, is very expensive, given the large, fixed cost element of these activities and facilities.

Concern about our cultural independence and debate on the subject has persisted from the time of Confederation. The concern increased with the decline of the British influence after World War I. In 1931 a tariff was placed on imported magazines and periodicals, other than those of a scientific, educational or religious nature. Initially a specific rate tariff, based upon weight, this was later altered and related to advertising content. The tariff was justified by the government as a revenue source. However, Mackenzie King, then leader of the opposition, stated in the House of Commons, that, "it is a further restriction of trade, it is again an effort to further the interests of a particular class at the expense of consumers."[60]

The effects of this tariff provide some insight into the history of Canadian policy relative to economic and cultural nationalism. The immediate impact was to reduce the circulation of imported periodicals and increase Canadian magazine sales. The next effect was for foreign publishers to create a Canadian subsidiary to produce the same magazines in order to recapture the market lost because of the tariff. A further unfortunate side effect was a reduction in the circulation of better quality imported periodicals. Mackenzie King denied that the tariff served any cultural purpose and removed it in 1935.

In the 1950's the share of the Canadian market held by U.S. magazines began to rise sharply. The government became concerned as to the cultural implications. In 1956 a tax on certain magazines was again enacted; the Finance Minister stated that "very exceptional measures can be justified — measures that certainly could not be justified in connection with any ordinary line of business." The 1956 tax was repealed by a new government in mid 1958.

In 1960 a Royal Commission on Publications was named. It had a pronounced interest in cultural questions in general, and American magazines in particular. The *Report* indicated a belief that, because of the inherent economic difficulties of Canadian publishing and their cultural importance, Canadian publishers should be protected.[61] The economic basis was the competitive advantage of the overflow from U.S. production runs. There was also a concern that U.S. firms would not allow their Canadian subsidiaries to advertise in Canadian magazines: this advertising would be redundant if Canadians were serviced from U.S. periodicals advertising the same products. Another factor was that special Canadian editions were thought to allow an unfair advantage to foreign publishers because some of the costs would be absorbed by other sales. Given the low cost of imported editorial material, compared to the initial cost to the U.S. editions, albeit with a wider circulation, the situation was compared to that of dumping in the international trade sense. This is considered an unfair competitive tactic and is discouraged by law and by special tariffs.

The Federal government announced its intention of proceeding with legislation to restrict the importation of periodicals bearing advertising specifically directed at the Canadian market, and eliminating the income tax deduction for Canadian oriented advertising in "foreign" periodicals. In the legislation introduced in 1965 *Time* and *Readers Digest* were excluded, even though these two magazines were the primary source of concern.

The 1961 *Report of the Royal Commission on Publications* was reinforced by the 1970 Senate Committee on the Mass Media, which regretted the exemption given to the two magazines.[62] During the interval the magazine industry in Canada continued to deteriorate. The Senators also noted that "Canada appears to be one of the few countries in the world which has taken no measures either to discourage overflow circulation or to encourage a domestic periodical industry."[63]

In July of 1975 the Secretary of State announced that the special tax status of *Readers Digest* and *Time* would be removed.

To qualify as a domestic publication the new legislation proposes that periodicals will have to be:

i) at least 75 percent Canadian-owned,

ii) free of licensing arrangements with foreign companies, and

iii) not substantially the same in content as foreign publications.

The contents of a Canadian periodical must be more than 80 percent different from material that has appeared in foreign periodicals.

In 1971 the Province of Ontario acted to restrict foreign investment in the distribution of periodicals and paperbacks by restricting foreign equity participation. This was in response to the planned sale to an American group of the largest Canadian magazine and paperback wholesaler.

Book publishing has many of the same features as the periodicals industry. Ontario has played an important role in the industry through its policy initiatives and because it is a major market. From 1966 to 1973 the dollar value of the market for English language books went from 149 million to 291 million while the total sales of Canadian-owned publishers stayed constant or declined.[64]

Ontario policy, because Ontario is the largest English language market, is crucial. Textbooks were prescribed at the provincial level for use by all students in primary and secondary schools until the 1950's. This, apparently, resulted in good markets and profits for Canadian (and British) firms and allowed lower volume, Canadian-authored books to be implicitly subsidized. With decentralization of decision making, and other changes in the Ontario educational system, the market for Canadian texts was reduced because American editions were less costly and, perhaps, more attractive.

The statistics are interesting: between 1966 and 1973 total provincial expenditures on education increased by 133 percent and expenditures on classroom and library books declined by 7.6 percent. As an associated development, Canadian and British publishing firms declined in size or were taken over by American publishers. Since this period Canadian subsidiaries of U.S. publishers have apparently been switching to supplying run-ons from U.S. editions.

One of the responses of the Ontario Government to the problems of the Canadian industry was the establishment of a Royal Commission on Book Publishing. In addition, the Government of Ontario provided a loan guarantee for working capital needed by McClelland and Stewart and other Ontario-based, Canadian-owned publishers. The Ontario Arts Council provides grants to Ontario-based, Canadian-owned publishers. Recently this was around 200 thousand dollars a year. The Canada Council also provides grants to Canadian-owned companies. The Secretary of State of the Federal Government and the Ontario Arts Council, are jointly trying to strengthen the marketing effectiveness of Canadian publishers. The Canada Council also buys books from Canadian-owned publishers to give away, both in Canada and abroad. The Federal Government provides grants to publishers. The Department of Industry, Trade and Commerce provides export marketing assistance.

Our largest export markets are obviously the United States and the United Kingdom,

from which we in turn receive the bulk of our English language book imports. We face a non-tariff barrier in the United States market in the form of the "manufacturing clause" in the United States Copyright Law. The U.S. did not sign the Berne convention and grants foreign authors copyright protection only if their books are remanufactured in the United States.[65]

The Council believes that Canada should try to improve the market for its books to lower the cost per book. It should be noted, however, that the worldwide interest in Canadian publications dealing with narrow cultural areas is unlikely to be great. Marketing and distribution costs for the short runs that are implicit would result in sharply increased costs. Penetrating the United States market would require a change in the non-tariff barrier mentioned above. Nonetheless, the provincial government should try to use its influence to gain the removal of all barriers to Canadian publications. The balance of trade in publications is so inordinately in favour of the United States that it would be difficult for the U.S. to justify rationally the retention of such a barrier. Canada and other countries could pursue this goal at the current round of GATT bargaining.

It is also likely that the removal of the Canadian tariff on fine papers would aid the publishing industry. Fine papers used in printing are apparently much more expensive in Canada than in the U.S.

Broadcasting

In the radio, television and cable television areas there are a number of relevant federal regulations. The Canadian Radio Broadcasting Corporation was formed in 1932, partly because of fears of possible U.S. domination of the industry. This was replaced by the Canadian Broadcasting Corporation. This is an example of public ownership in a key sector to preserve a Canadian industry and identity. In 1958 an amendment to the *Broadcasting Act* limited foreign participation in the ownership of television stations to 25 percent. This was extended to radio and cable television in 1964. Further regulations cover other aspects of Canadian content. The Canadian Radio-Television Commission requires 60 percent Canadian content for television stations (50 percent between 6 p.m. and midnight) and a 30 percent Canadian component for recorded music on radio.

These regulations are difficult to analyze. To some extent they are a tax on the license holders. To some extent they reduce consumer freedom. They are also tantamount to a subsidy for those providing Canadian entertainment inputs. During 1972, the Canadian Broadcasting Corporation engaged roughly 30,000 Canadian performers and paid them fees of $23 million. While content regulations may be viewed with distaste by those committed to the market system they were, in essence, highly political decisions. During the Council's recent tour of Northern Ontario an interest in more American programming for remote regions (via cable TV) was expressed. The choice offered by Canadian sources was felt to be inadequate. Here is a case where rules and regulations (decided in this case, at least a thousand miles away by those with a much wider choice of programs) are perceived by those affected to be detrimental to local needs.

Education

The educational system presents a number of contentious issues related to cultural nationalism. The Select Committee of the Ontario Legislature on Economic and Cultural Nationalism has issued an interim report on *Colleges and Universities in Ontario*[66] as well as a *Final Report on Cultural Nationalism.*[67] The Committee gave "considerable emphasis on the need for a more substantial and systematic Canadian presence in colleges and universities in Ontario and a strong and conspicuous Canadian presence in curricula and materials at all junior levels of education from the level of kindergarten." The Committee recommended in its interim report that "All chancellors, boards of governors or equivalents, presidents, vice presidents, deans and chairmen of departments at universities in Ontario be Canadians." It also recommended machinery that would increase the proportion of Canadian citizens given faculty appointments, as well as a number of other policies to "Canadianize" higher education in Ontario.

In Canadian universities there are many foreign teachers. Given the degree of specialization in many university faculties it is not surprising that Canada should import trained professors. It should be borne in mind that Canada is usually the net beneficiary. We receive the benefits of the foreign trained without having spent large sums to educate each professor. Setting aside questions of cultural differences and differences in social and political backgrounds, this is a clear gain and not a loss to Canada. Furthermore, why should young Canadians not have the benefit of the best professors available, whether they be foreign or Canadian?

The enormous development of Ontario universities occurred when there were few domestic sources of good teachers. That situation has changed and in many fields the development of graduate studies in Canada is such that many of the faculty now come from Canadian universities. At present access to United States sources provides a safety valve for universities if educational tastes or demands change. Without carrying an inventory of Canadian professors in subjects which are highly specialized, where demand is variable, and where a field is subject to rapid change, we can reduce our costs by tapping the huge United States supply for the small swings in our needs.

In many fields of specialization Canadian graduates rank with the best in the world. In some they do not. To legislate Canadian citizenship or Canadian training requirements in the view of the Council would be a mistake. Although it has often been suggested, there is no evidence that the government is contemplating such a move.

Because of the slower growth of the universities, there is a difficulty in a few disciplines in providing jobs for Ph.D. graduates from Canadian universities. Canadian graduates must, at a minimum, have equal access to university jobs. Hiring by non-university employers should also be encouraged. This is compatible with the frequently expressed concern that Canadian industry has a poor research and development record — a circumstance reflected in its employment of Ph.D. level staff. There is also an unsatisfied demand in Canada for those with advance training in such activities as management science and urban planning. Thought should be given to the development and dissemination of better information and forecasts of job opportunities in particular disciplines.

Other Areas of Concern

There are many other areas of public concern. Advertising is one. The Select Committee considered the question of advertising and issued an interim report entitled *Advertising and the Advertising Industry*.[68] It contains eleven recommendations. Recently, the Canadian Radio Television Commission proposed a regulation requiring a minimum of 70 percent Canadian content for commercials for radio and television, with this proportion rising to 80 percent by 1978. As well, from 1977 on, all recorded musical and other identifications used by radio stations must be produced and recorded in Canada.

The *Foreign Investment Review Act* has an impact on cultural activities. For example, as part of a takeover approved by *FIRA*, the Capital Record Club agreed to spend at least $300,000 a year to develop musical talent in French speaking and English speaking Canada. It also agreed to feature a Canadian performer in its monthly magazine.

To analyze all of these programs — and there are others which have not been mentioned — is beyond our competence or resources. Many have the effect of subsidizing particular groups, such as Canadian entertainers, by increasing the demand for their services and, as a consequence their incomes. Many, presumably, increase the sense of "being Canadian". Some of the activities are highly uneconomic because of sharply decreasing costs of production and the limited size of the Canadian market. The continuation of many Canadian cultural activities requires either restrictions or subsidies.

V. SUMMARY AND MAIN POLICY ISSUES

1. One of the Council's purposes in this paper has been to point out that questions of nationalism, and particularly the economics of nationalism, frequently are not as simple as they appear. The Council also hopes that this report demonstrates that many, though certainly not all, of the problems of national independence are caused by Canadian economic policies. It would likely be counter-productive to attempt to reduce foreign ownership without tackling the underlying causes inherent in existing Canadian policies.

2. The Foreign Investment Review Agency is playing a powerful role in screening foreign investment. Given the difficulty of deciding how the net benefits of foreign investment are to be determined (much less maximized), and the lack of public knowledge of the decision-making rules and processes, there is some doubt whether the best interests of Canadians are being served as well as they might be. Given the small size of the Canadian market and the degree to which competition varies in particular Canadian industries, the determination of net benefits that flow from the presence of tariffs is a complex calculation. Furthermore the allocation of benefits and costs among industries, labour, consumers, and regions is important. The factors considered in the decision-making process are not revealed to those affected except the firms directly involved. Since the Foreign Investment Review Agency looks at individual cases, such macro-economic effects as the exchange rate or interest rate effects, are not evaluated, notwithstanding the fact they alter the costs and benefits for the country as a whole. (see pages 13-15 of text).

3. The tariff is a principal cause of much foreign investment in Canada and of the reduced efficiency of Canadian industry; it results in per capita income being below what it would be in the absence of the tariff. The Council believes that a strong case can be made for exploring major reductions in tariff levels. One of the many potential advantages is that some of the difficulties associated with foreign direct investment would be alleviated. (see pages 15, 16 of text).

4. Canadian competition policy is closely related to the question of foreign investment. Competition policy has developed slowly in this country. The Council feels that the merging of companies is one of the important areas for concern. Foreign firms often increase competition; they should be considered as a potential source of increased competition where this is needed. The Foreign Investment Review Act, the prohibition of foreign investment in "key sectors" and other policies, in fact, act to reduce competition. Canadians should be aware that restricting foreign firms without increasing competition could be counterproductive. (see pages 17, 18 of text).

5. There is room for both federal and provincial initiatives in the financial sector, ranging from chartered banking to securities dealers. Changes could help to finance more Canadian owned firms. More competition in commercial banking could increase lending to smaller, developing Canadian firms. More competition in securities underwriting and brokerage could reduce the cost of these services and result in Canadians making more use of equity markets. (see pages 18-20 of text).

6. Tax policies need to be reviewed to ensure that they are fully consistent with the somewhat conflicting goals of reducing foreign ownership and control, maximizing the

tax returns on foreign investment to Canada, and maintaining a high level of investment (see pages 20-23 of text).

7. Distinctive cultural achievements will be difficult and costly to obtain because of the "decreasing cost" nature of the production of cultural activities. Subsidies to Canadians, rather than restrictions on foreigners, are a better policy approach under most circumstances. (see pages 27-32 of text).

8. Canadians can choose any position between substantial independence and a high degree of interdependence. The choice that is made will have important repercussions on both the levels and the distribution of income and wealth among Canadian provinces, regions, occupations and individuals in these subgroups.

   There are unlikely to be costless gains. The effect of nationalist policies is often to increase jobs and benefits for particular groups at the expense of the population at large. A more rational policy-making process requires that Canadians be made more aware of the costs of policy changes and the incidence of these costs on various sectors of the community. (see pages 3-6, 8 of text).

9. Policies concerned with national independence have developed in a piece-meal fashion. In order to promote national goals more effectively and at minimum cost a more comprehensive approach is required in which the side-effects of many domestic policies are taken into account.

DISSENTING COMMENT

I consider the question of Canadian independence in our complex and inter-related world to be of such importance that I would like to identify one or two examples of my concerns about and disagreements with the report on "National Independence: Alternatives" while at the same time welcoming the report as a further contribution to the discussion of this basic issue.

I do not subscribe to the proposition that "Canadians cannot be more economically and culturally independent and, concurrently, be better off. We cannot 'have our cake and eat it too' ". I do not believe that we could not as a society develop our material and human resources in ways which would enhance both our independence and our standard of living. I am not persuaded, for similar reasons, that crown corporations do not represent an appropriate device, in more rather than fewer situations, for both economic development and independence.

The basic difficulty with many of our larger private economic institutions is their lack of social accountability - the kind of test of benefit to Canada, for example, which *FIRA* applies to foreign companies might well be applied to Canadian companies as well. Simply opening up the country to more competition from foreign firms in some areas would not necessarily do anything about this problem, and might well be counter-productive both in terms of efficiency and independence.

Lynn R. Williams

FOOTNOTES

CHAPTER I

1. The correct title of the "Watkins Report" was *Report of the Task Force on the Structure of Canadian Industry*, Privy Council Office, Ottawa, 1968. The Wahn document is the Eleventh Report of the *Standing Committee on External Affairs and National Defense Respecting Canada-US. Relations*, Queen's Printer, Ottawa, 1970. Gray was the cabinet minister responsible for "bringing forward proposals on foreign investment policy for the consideration of the government" in *Foreign Direct Investment in Canada*, Information Canada, Ottawa, 1972. The Select Committee on Economic and Cultural Nationalism of the Ontario Legislature has published a *Preliminary Report* (1972), five *Interim Reports* (1973 and 1974) and two Final Reports - *Final Report on Economic Nationalism* (1975) and *Final Report on Cultural Nationalism* (1975). All were published by the Queen's Printer for Ontario. Other publications include two by Safarian, *Foreign Ownership of Canadian Industry*, McGraw-Hill, Toronto, 1966 and *The Performance of Foreign-Owned Firms in Canada*, Canadian-American Committee, Private Planning Association, Montreal, 1969. Kari Levitt's *Silent Surrender*, Macmillan Toronto, 1971 was popular. Recently Fayerweather has produced a book dealing with Canadian attitudes and policy making, *Foreign Investment in Canada*, Oxford University Press, Toronto, 1974.

2. A complete reference to the *Interim Reports* is contained in the *Final Report on Economic Nationalism*, Queen's Printer for Ontario, 1975. In addition some work undertaken for the Select Committee by outside consultants has also been published. These are also cited in the *Final Report on Economic Nationalism.*

CHAPTER II

3. R.A. Mundell, "International Trade and Factor Mobility", Chapter 6 in *International Economics*, Macmillan, New York, 1968.

4. Many of these are mentioned in A.E. Safarian, *Canadian Federalism and Economic Integration*, Information Canada, Ottawa, 1974.

5. Economic Council of Canada, *Economic Goals for Canada to 1970*, Queen's Printer, Ottawa, 1964, p. 1.

6. Economic Council, *op. cit.*, p. 1.

7. Science Council of Canada, *Towards a National Science Policy for Canada*, Queen's Printer, Ottawa, 1969, pp. 13-18.

8. See, for example John Helliwell and Julian Broadbent, "How Much Does Foreign Capital Matter", *BC Studies*, No. 13, Spring 1972, pp. 38-42.

9. J.A. Murray and L. Leduc, "A Cross-Sectional Analysis of Canadian Public Attitudes Towards U.S. Equity Investment in Canada," Ontario Economic Council Working Paper Series, No. 2/75.

10. Perhaps tastes would be altered by continuous exposure at relatively favourable prices

to Canadian cultural activities, so that the foreign output would not be greatly demanded even at lower prices after the tariff was removed.

11. The reader is referred to *Report of the Royal Commission on Taxation*, Volume 2, Queen's Printer, Ottawa, 1966, pp. 21-23.

12. See for example, P.A. Neher, "Capital Movement, Foreign Ownership and Dependence on Foreign Investment in Canada and British Columbia", *BC Studies*, No. 13, Spring 1972, p. 35.

13. W.D. McKeough, Remarks to the Canada-Israel Chamber of Commerce and Industry, Toronto, 13 March 1975, p. 4.

14. J.E. Cooney, "Clampdown by Canadians on Investing by Aliens Alarms Multinational Firms", *Wall Street Journal*, May 7, 1975, p. 42.

CHAPTER III

15. For more complete listings and details of federal and provincial policies see: *Extracts from Provincial Laws and Regulations Affecting Foreign Investment in Canada, December 1974*, Policy Research Division, Research and Analysis Branch, Foreign Investment Review Agency, Ottawa, 10 January, 1975; *Selected Readings in Laws and Regulations Affecting Foreign Investment in Canada, March 1972*, Foreign Investment Division, Office of Economics, Department of Industry, Trade and Commerce, Ottawa, 20 March 1972.

16. "Behaviour Rules for Companies are Dusted Off", *Financial Post*, August 9, 1975, p. 12.

17. There is substantial evidence on the scale and costs of Canadian secondary manufacturing industries. For example Caves states

> Most analyses of Canada's secondary manufacturing industries agree on the following propositions: These industries are condemned to relatively small scale operation by the size of the national market and the structure of the nation's international trade.

R.E. Caves, *Diversification, Foreign Investment, and Scale in North American Manufacturing Industries*, Economic Council of Canada, Information Canada, 1975, p. 3.

18. Safarian has shown that imports as a share of total purchases were significantly greater for foreign owned secondary manufacturing firms: A.E. Safarian, *Foreign Ownership of Canadian Industry*, McGraw-Hill, Toronto, 1966, p. 295. This is supported by B.W. Wilkinson, *Canada's International Trade: An Analysis of Recent Trends and Patterns*, Private Planning Association, Montreal, 1968, Chapter 7.

19. *21-22 Elizabeth II*, Chapter 46, Section 2(2), p. 620.

20. J.E. Cooney, *op. cit.*

21. See Economic Council of Canada, *Looking Outward*, Information Canada, Ottawa, 1975, pp. 10-17.

22. For references the reader is referred to the study by Caves mentioned above as well as Chapter Three in the Economic Council of Canada's recent report, *Looking Outward*, pp. 25-37.

23. See *Looking Outward, op. cit.*, p. 33.

24. With respect to the above discussion the Economic Council of Canada concluded (*Looking Outward* p. 37):

    > The lingering protection in Canada and foreign countries still largely confines Canadian secondary industry to a relatively small market, and this had adverse effects on the growth of productivity and real incomes, as well as on the extent and pattern of foreign ownership, the pace of technological advance, and the development of innovative capability. In short, commercial policy has contributed to a deterioration of this country's capacity for sustained, dynamic, autonomous growth - a capacity that will become increasingly important in the future. Thus the results of a long evolution of trade policies can hardly be viewed as a contribution to independent national decision-making in Canada.

25. See *Looking Outward, op. cit.*, pp. 26-31 for a discussion of productivity growth.

26. P.V. Lyon, *Canada-United States Free Trade and Canadian Independence*, Economic Council of Canada, Information Canada, Ottawa, 1975.

27. G. Rosenbluth, "The Relation between Foreign Control and Concentration in Canadian Industry", *Canadian Journal of Economics*, February 1970, p. 19.

28. Rosenbluth, *op. cit.*, p. 28.

29. R.E. Caves, "Multinational Firms, Competition and Productivity in Host-Country Markets", *Economica*, May 1974, pp. 176-193.

30. R.E. Caves, "Causes of Direct Investment: Foreign Firms Shares in Canadian and United Kingdom Manufacturing Industries", *Review of Economics and Statistics*, August 1974, pp. 279-293.

31. H. Block, "Prices, Costs, and Profits in Canadian Manufacturing: the influence of tariffs and concentration", *Canadian Journal of Economics*, November 1974, pp. 594-610.

32. See, for example, the Bank of Nova Scotia's brief *A Study of Foreign Banking in Canada*, Toronto, May 1974, and Grant L. Reuber, "An Evaluation of the Bank Act, 1967", University of Western Ontario (Mimeo).

33. *Report. . . .*page 138.

34. *Loc. Cit.* page 140.

35. See J. Fayerweather, *Foreign Investment in Canada*, Oxford University Press, Toronto, 1974, p. 101, or amendments to the *Ontario Securities Act* in "Publication under the Regulations Act" *The Ontario Gazette*, various issues.

36. H. Anderson "Cut-rate Commissions proposed for share trading in 6 big firms, "*Globe and Mail Report on Business*, April 3, 1975, p. B1: and I. Lutsky, "TSE firms favour fixed commissions by large margin," *Globe and Mail Report on Business*, April 18, 1975, p. B1.

37. For a discussion see G.L. Reuber, *Private Foreign Investment in Development*,

Clarendon Press, Oxford, 1973, Chapter 2, particularly pages 17-30.

38. For further details the reader may consult, G. Jenkens and A. Deutsch, "Foreign Tax Credits and the Interdependence of Corporate Tax Policies", *Discussion Paper Series*, Harvard Institute of Economic Research, Cambridge, Massachusetts, October, 1974.

39. *Report of the Royal Commission on Taxation*, Volume 2, Queen's Printer, Ottawa, 1966, p. 253.

40. "Ottawa to increase tax watch on firms using foreign units," *Globe and Mail Report on Business*, June 13, 1975, p. B4.

41. The Honourable John White, *The Ontario 1973 Budget*, Ministry of Treasury, Economics and Intergovernmental Affairs, Toronto, April 1973, p. 23.

42. *Double Taxation of Income and Capital*, OECD, 1974.

43. See for example, J.S. Peterson, "Canada's New Tax Treaties," *Canadian Tax Journal*, XXIII, No. 4 (July-August 1975), pp. 26-27.

44. *Report of the Royal Commission on Taxation*, Queen's Printer, Ottawa, 1966. Various volumes.

45. P. Bourgault, *Innovation and the Structure of Canadian Industry*, Science Council of Canada Special Study No. 23, Information Canada, Ottawa, 1972, pp. 37-39.

46. Bourgault, p. 60.

47. Bourgault, p. 61.

48. Bourgault, p. 54-60.

49. A.J. Cordell, *The Multinational Firm, Foreign Direct Investment and Canadian Science Policy*, Science Council of Canada Special Study No. 22, Information Canada, Ottawa, 1971, Chapter 3.

50. For a reference to some United States practices see *Tax Allocations and International Business*, The Conference Board, New York, 1972.

51. See Bourgault, pp. 56-60.

52. *Ontario Research Foundation Annual Report 1974*, p. 33.

53. P.M. Goldberg and C.P. Kindleberger, "Toward a GATT for Investment: A proposal for Supervision of the International Corporation," *Law and Policy in International Business*, Summer 1970, pp. 295-325.

54. Select Committee on Economic and Cultural Nationalism, *Foreign Ownership of Ontario Real Estate*, Queen's Printer for Ontario, Toronto 1973.

55. *Loc. Cit.* p. 12.

56. See D. Andison, "An Overview of the Ontario Land Transfer Tax", *1974 Conference Report*, Canadian Tax Foundation, Toronto, 1975, pp. 388-396.

57. R.S. Smith, "An Economic Evaluation", *1974 Conference Report*, Canadian Tax Foundation, Toronto, 1975, p. 416.

58. L.B. Smith, "The Economic Implications of the Ontario Land Speculation Tax", *1974 Conference Report*, Canadian Tax Foundation, Toronto, 1975, p. 692.

59. For a background see Andison, *op. cit.*, p. 390-391.

CHAPTER IV

60. House of Commons Debates (Hansard) July 17, 1931, p. 3889. Litvak and Maule have recently stated that "the legislation undoubtedly resulted from the activity of certain Canadian publishers and the Canadian Manufacturers Association". I. Litvak and C. Maule, *Cultural Sovereignty*, Praeger Publishing, New York, 1974, p. 24. Much of the material in this section has benefitted from this book.

61. *Report of the Royal Commission on Publications*, Queen's Printer, Ottawa, 1961.

62. *Report of the Special Senate Committee on Mass Media*, Volume 1, Queen's Printer, Ottawa, 1970.

63. *Loc. Cit.* p. 157.

64. J. Lorimer, "The Political Economy of Canadian Publishing", *This Magazine*, July-August, 1975.

65. This apparently occurred because of a tradition of not granting, at the state level, property rights to foreigners, and because the U.S. industry developed by pirating British works. See W.E. Curry, "The Impact of the U.S. Manufacturing Provisions", *Background Papers*, Royal Commission on Book Publishing, Ontario, 1972.

66. Select Committee on Economic and Cultural Nationalism, *Interim Report, Colleges and Universities in Ontario*, Queen's Printer for Ontario, Toronto, 1973.

67. Select Committee on Economic and Cultural Nationalism, *Final Report on Cultural Nationalism*, Queen's Printer for Ontario, Toronto, 1975.

68. Select Committee on Economic and Cultural Nationalism, *Interim Report, Advertising and the Advertising Industry*, Queen's Printer for Ontario, Toronto, 1974.

HC
117
.06
.I8262

Ontario Economic Council.

National independence.

REFERENCE COPY